

Did the Fed Pivot Finally Arrive? Yes.

The Federal Reserve Open Market Committee concluded their 2-day meeting yesterday and surprised markets with an unexpectedly dovish twist by adding rate cuts to the year 2024 forecast. The median forecast now calls for three 25 basis point rate cuts in 2024 followed by seven additional cuts in 2025 and 2026. This was more than previously forecast. Driving the change, you guessed it, is a realization that inflation is declining faster than previously envisioned.

For those of you that read our monthly commentary, this is something I thought would be on the horizon for some time given the rapid decline in inflation while economic growth and labor markets remained positive. Not proactively trimming rates, in my view, is a mistake that compromises the economic recovery from the 2020 COVID lows that took almost \$6 trillion in stimulus to bring back to life. Why jeopardize such progress unnecessarily?

So where do I think we are headed in the year ahead? The Fed has spilled a lot of academic ink that shows the appropriate neutral federal funds rate is one that is 0.50% above their targeted trend rate of 2% inflation, or a policy rate of 2.50%. This is why their projections have consistently called for a long-run policy rate of 2.50% throughout this cycle as they have not relented on their 2% inflation target. I fully take their word on their target, or they risk damaging their credibility. The Fed's latest forecast calls for a yearend 2024 core inflation rate of 2.4%. Keeping policy unchanged would lead to a real policy rate of nearly 3%, well above their neutral estimate of 0.50% and one that risks economic progress. Barring any shocks that alter the path of the economy, I expect the Fed to trim rates perhaps as much as four to six times over the next several quarters to begin to close that gap and slowly take pressure off the economy while remaining restrictive enough to ensure inflation doesn't rear its head again.

As always, reach out if you have any questions.

Garrett Cudahey, Chief Investment Officer